

Introduced by Senator Dutton

February 22, 2005

An act to add Sections 6377, 17053.49, and 23649 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

SB 631, as introduced, Dutton. Real Investment in California's Economy Program: personal income and corporation taxes: sales and use tax: credit and exemptions.

The Sales and Use Tax Law imposes a tax on the gross receipts from the sale in this state of, or the storage, use, or other consumption in this state of, tangible personal property and provides various exemptions from the taxes imposed by that law.

This bill would provide, for calendar years beginning on or after January 1, 2006, an exemption from those taxes for the gross receipts from the sale of, and the storage, use, or other consumption of, tangible personal property, as defined, purchased for use by a qualified person, as defined, primarily in any state of manufacturing, including the generation of electricity, processing, refining, fabricating, or recycling of property, and introduced into the process, as specified.

The Personal Income Tax Law and the Corporation Tax Law authorize various credits against the taxes imposed by those laws.

This bill, for taxable years beginning on or after January 1, 2006, would allow a credit against taxes imposed by those laws in an amount equal to 6% of the amount paid or incurred by the taxpayer during the taxable year for qualified property, as defined, that is placed in service in this state.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. This act shall be known and cited as the Real
2 Investment in California's Economy Program.
- 3 SEC. 2. Section 6377 is added to the Revenue and Taxation
4 Code, to read:
- 5 6377. (a) For calendar years beginning on and after January
6 1, 2006, there are exempted from the taxes imposed by this part
7 the gross receipts from the sale of, and the storage, use, or other
8 consumption in this state of, any of the following:
- 9 (1) Tangible personal property purchased for use by a
10 qualified person to be used primarily in any stage of the
11 manufacturing, processing, refining, fabricating, or recycling of
12 property, beginning at the point any raw materials are received
13 by the qualified person and introduced into the process and
14 ending at the point at which the manufacturing, processing,
15 refining, fabricating, or recycling has altered property to its
16 completed form, including packaging, if required.
- 17 (2) Tangible personal property purchased for use by a
18 qualified person to be used primarily in research and
19 development.
- 20 (3) Tangible personal property purchased for use by a
21 qualified person to be used primarily to maintain, repair,
22 measure, or test any property described in paragraph (1) or (2).
- 23 (4) Tangible personal property purchased for use by a
24 contractor purchasing that property either as an agent of a
25 qualified person or for the contractor's own account and
26 subsequent resale to a qualified person for use in the performance
27 of a construction contract for the qualified person who will use
28 the tangible personal property as an integral part of the
29 manufacturing, processing, refining, fabricating, or recycling
30 process, or as a research or storage facility for use in connection
31 with the manufacturing process.
- 32 This exemption does not apply to any tangible personal
33 property that is used primarily in administration, general
34 management, or marketing.
- 35 (b) For purposes of this section:

1 (1) “Fabricating” means to make, build, create, produce, or
2 assemble components or property to work in a new or different
3 manner.

4 (2) “Manufacturing” means the activity of converting or
5 conditioning property by changing the form, composition,
6 quality, or character of the property for ultimate sale at retail or
7 use in the manufacturing of a product to be ultimately sold at
8 retail, and includes the generation of electricity. Manufacturing
9 includes any improvements to tangible personal property that
10 result in a greater service life or greater functionality than that of
11 the original property.

12 (3) “Primarily” means tangible personal property used 50
13 percent or more of the time in an activity described in
14 subdivision (a).

15 (4) “Process” means the period beginning at the point at which
16 any raw materials are received by the qualified taxpayer and
17 introduced into the manufacturing, processing, refining,
18 fabricating, or recycling activity of the qualified taxpayer and
19 ending at the point at which the manufacturing, processing,
20 refining, fabricating, or recycling activity of the qualified
21 taxpayer has altered tangible personal property to its completed
22 form, including packaging, if required. Raw materials shall be
23 considered to have been introduced into the process when the
24 raw materials are stored on the same premises where the
25 qualified taxpayer’s manufacturing, processing, refining, or
26 recycling activity is conducted. Raw materials that are stored on
27 premises other than where the qualified taxpayer’s
28 manufacturing, processing, refining, fabricating, or recycling
29 activity is conducted, shall not be considered to have been
30 introduced into the manufacturing, processing, refining,
31 fabricating, or recycling process.

32 (5) “Processing” means the physical application of the
33 materials and labor necessary to modify or change the
34 characteristics of property.

35 (6) “Qualified person” means any person that is both of the
36 following:

37 (A) A new trade or business. In determining whether a trade or
38 business activity qualifies as a new trade or business, the
39 following rules apply:

(i) In any case where a person purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of entity) that is doing business in this state (within the meaning of Section 23101), the trade or business thereafter conducted by that person (or any related person) may not be treated as a new business if the aggregate fair market value of the acquired assets (including, real, personal, tangible, and intangible property) used by that person (or any related person) in the conduct of his or her trade or business exceed 20 percent of the aggregate fair market value of the total assets of the trade or business being conducted by the person (or any related person). For purposes of this subparagraph only, the following rules apply:

(I) The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the month following the quarterly period in which the person (or any related person) first uses any of the acquired trade or business assets in his or her business activity.

(II) Any acquired assets that constituted property described in Section 1221(a) of the Internal Revenue Code in the hands of the transferor may not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Section 1221(a) of the Internal Revenue Code in the hands of the acquiring person (or related person).

(ii) In any case where a person (or any related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (“prior trade or business activity”), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the person’s (or any related person’s) current or prior trade or business activities in this state.

(iii) In any case where a person, including all related persons, is engaged in trade or business activities wholly outside of this state and that person first commences doing business in this state (within the meaning of Section 23101) after January 1, 2005

1 (other than by purchase or other acquisition described in clause
2 (i)), the trade or business activity shall be treated as a new
3 business.

4 (iv) In any case where the legal form under which a trade or
5 business activity is being conducted is changed, the change in
6 form shall be disregarded and the determination of whether the
7 trade or business activity is a new business shall be made by
8 treating the person as having purchased or otherwise acquired all
9 or any portion of the assets of an existing trade or business under
10 the rules of clause (i).

11 (v) “Related person” means any person that is related to that
12 person under either Section 267 or 318 of the Internal Revenue
13 Code.

14 (vi) “Acquire” includes any gift, inheritance, transfer incident
15 to divorce, or any other transfer, whether or not for consideration.

16 (B) Engaged in those lines of business described in Codes
17 2011 to 3999, inclusive, or Code 4911 of the Standard Industrial
18 Classification Manual published by the United States Office of
19 Management and Budget, 1987 edition.

20 (7) Notwithstanding paragraph (6), “qualified person” does not
21 include any person who has conducted business activities in a
22 new trade or business for three or more years.

23 (8) “Refining” means the process of converting a natural
24 resource to an intermediate or finished product.

25 (9) “Research and development” means those activities that
26 are described in Section 174 of the Internal Revenue Code or in
27 any regulations thereunder.

28 (10) “Tangible personal property” does not include any of the
29 following:

30 (A) Consumables with a normal useful life of less than one
31 year, except as provided in subparagraph (E) of paragraph (11).

32 (B) Furniture, inventory, equipment used in the extraction
33 process, or equipment used to store finished products that have
34 completed the manufacturing process.

35 (C) Any property for which a credit is claimed under either
36 Section 17053.49 or 23649.

37 (11) “Tangible personal property” includes, but is not limited
38 to, all of the following:

1 (A) Machinery and equipment, including component parts and
2 contrivances such as belts, shafts, moving parts, and operating
3 structures.

4 (B) All equipment or devices used or required to operate,
5 control, regulate, or maintain the machinery, including, without
6 limitation, computers, data processing equipment, and computer
7 software, together with all repair and replacement parts with a
8 useful life of one or more years therefor, whether purchased
9 separately or in conjunction with a complete machine and
10 regardless of whether the machine or component parts are
11 assembled by the taxpayer or another party.

12 (C) Property used in pollution control that meets or exceed
13 standards established by this state or any local or regional
14 governmental agency within this state.

15 (D) Special purpose buildings and foundations used as an
16 integral part of the manufacturing, processing, refining, or
17 fabricating process, or that constitute a research or storage
18 facility used during the manufacturing process. Buildings used
19 solely for warehousing purposes after completion of the
20 manufacturing process are not included.

21 (E) Fuels used or consumed in the manufacturing process.

22 (F) Property used in recycling.

23 (c) No exemption is allowed under this section unless the
24 purchaser furnishes the retailer with an exemption certificate,
25 completed in accordance with any instructions or regulations as
26 the board may prescribe, and the retailer subsequently furnishes
27 the board with a copy of the exemption certificate. The
28 exemption certificate shall contain the sales price of the
29 machinery or equipment that is exempt pursuant to subdivision
30 (a).

31 (d) Notwithstanding any provision of the Bradley-Burns
32 Uniform Local Sales and Use Tax Law (Part 1.5 (commencing
33 with Section 7200)) or the Transactions and Use Tax Law (Part
34 1.6 (commencing with Section 7251)), the exemption established
35 by this section does not apply with respect to any tax levied by a
36 county, city, or district pursuant to, or in accordance with, either
37 of those laws.

38 (e) (1) Notwithstanding subdivision (a), the exemption
39 provided by this section does not apply to any sale or use of
40 property which, within one year from the date of purchase, is

1 either removed from California or converted from an exempt use
2 under subdivision (a) to some other use not qualifying for the
3 exemption.

4 (2) Notwithstanding subdivision (a), on or after January 1,
5 2006, the exemption established by this section does not apply
6 with respect to any tax levied pursuant to Sections 6051.2 and
7 6201.2, or pursuant to Section 35 of Article XIII of the California
8 Constitution.

9 (f) If a purchaser certifies in writing to the seller that the
10 property purchased without payment of the tax will be used in a
11 manner entitling the seller to regard the gross receipts from the
12 sale as exempt from the sales tax, and within one year from the
13 date of purchase, the purchaser (1) removes that property outside
14 California, (2) converts that property for use in a manner not
15 qualifying for the exemption, or (3) uses that property in a
16 manner not qualifying for the exemption, the purchaser shall be
17 liable for payment of sales tax, with applicable interest, as if the
18 purchaser were a retailer making a retail sale of the property at
19 the time the property is so removed, converted, or used, and the
20 sales price of the property to the purchaser shall be deemed the
21 gross receipts from that retail sale.

22 (g) This section applies to leases of tangible personal property
23 classified as “continuing sales” and “continuing purchases” in
24 accordance with Sections 6006.1 and 6010.1. The exemption
25 established by this section applies to the rentals payable pursuant
26 to such a lease, provided the lessee is a qualified person and the
27 property is used in an activity described in subdivision (a).
28 Rentals that meet the foregoing requirements are eligible for the
29 exemption for a period of six years from the date of
30 commencement of the lease. At the close of the six-year period
31 from the date of commencement of the lease, lease receipts are
32 subject to tax without exemption.

33 SEC. 3. Section 17053.49 is added to the Revenue and
34 Taxation Code, to read:

35 17053.49. (a) For taxable years beginning on or after January
36 1, 2006, a qualified taxpayer is allowed a credit against the “net
37 tax,” as defined in Section 17039, equal to 6 percent of the
38 qualified cost of qualified property that is placed in service in this
39 state.

(b) For purposes of this section, “qualified cost” means any cost that satisfies each of the following conditions:

(1) Is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 2006.

(2) Except as provided in paragraph (3) of subdivision (d) and subparagraph (B) of paragraph (4) of subdivision (d), is an amount upon which the qualified taxpayer has paid, directly or indirectly, as a separately stated contract amount or as determined from the records of the qualified taxpayer, sales or use tax under Part 1 (commencing with Section 6001).

(3) Is an amount properly chargeable to the capital account of the qualified taxpayer.

(c) (1) For purposes of this section, “qualified taxpayer” means any of the following:

(A) A taxpayer engaged in those lines of business described in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373, inclusive, or Code 4911 of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(B) Any taxpayer that provides broadband services or leases equipment to a broadband services provider.

(C) A subsidiary, affiliate, partner, or coventurer of a taxpayer that provides broadband services or leases equipment to a broadband services provider.

(2) In the case of any passthrough entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 23649 shall be allowed to the passthrough entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph, the term “passthrough entity” means any partnership or “S” corporation.

(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.

(d) For purposes of this section, “qualified property” means property that is described as any of the following:

(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to 3999, inclusive, or Code 4911 of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, that is primarily used for any of the following:

(A) For the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(B) In research and development.

(C) To maintain, repair, measure, or test any property described in this paragraph.

(D) For pollution control that meets or exceeds standards established by the state or by any local or regional governmental agency within the state.

(E) For recycling.

(2) Computers and computer peripheral equipment, as defined in Section 168(i)(2)(B) of the Internal Revenue Code, that is tangible personal property as defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in SIC Codes 7371 to 7373, inclusive, of the SIC Manual, 1987 edition, that is primarily used to develop or manufacture prepackaged software or custom software prepared to the special order of the purchaser who uses the program to produce and sell or license copies of the program as prepackaged software.

(3) The value of any capitalized labor costs that are directly allocable to the construction or modification of property described in paragraph (1) or (2).

(4) In the case of any qualified taxpayer engaged in manufacturing activities described in SIC Code 357 or 367, those activities related to biotechnology described in SIC Code 8731, those activities related to biopharmaceutical establishments only

1 that are described in SIC Codes 2833 to 2836, inclusive, those
2 activities related to space vehicles and parts described in SIC
3 Codes 3761 to 3769, inclusive, those activities related to space
4 satellites and communications satellites and equipment described
5 in SIC Codes 3663 and 3812, or those activities related to
6 semiconductor equipment manufacturing described in SIC Code
7 3559, or those activities related to electric power generation
8 described in SIC Code 4911, “qualified property” also includes
9 the following:

10 (A) Special purpose buildings and foundations that are
11 constructed or modified for use by the qualified taxpayer
12 primarily in a manufacturing, processing, refining, or fabricating
13 process, or as a research or storage facility primarily used in
14 connection with a manufacturing process.

15 (B) The value of any capitalized labor costs that are directly
16 allocable to the construction or modification of special purpose
17 buildings and foundations that are used primarily in the
18 manufacturing, processing, refining, or fabricating process, or as
19 a research or storage facility primarily used in connection with a
20 manufacturing process.

21 (C) (i) For purposes of this paragraph, “special purpose
22 building and foundation” means only a building and the
23 foundation immediately underlying the building that is
24 specifically designed and constructed or reconstructed for the
25 installation, operation, and use of specific machinery and
26 equipment with a special purpose, which machinery and
27 equipment, after installation, will become affixed to or a fixture
28 of the real property, and the construction or reconstruction of
29 which is specifically designed and used exclusively for the
30 specified purposes as set forth in subparagraph (A) (“qualified
31 purpose”).

32 (ii) A building is specifically designed and constructed or
33 modified for a qualified purpose if it is not economical to design
34 and construct the building for the intended purpose and then use
35 the structure for a different purpose.

36 (iii) For purposes of clause (i) and clause (vi), a building is
37 used exclusively for a qualified purpose only if its use does not
38 include a use for which it was not specifically designed and
39 constructed or modified. Incidental use of a building for
40 nonqualified purposes does not preclude the building from being

1 a special purpose building. “Incidental use” means a use that is
2 both related and subordinate to the qualified purpose. It will be
3 conclusively presumed that a use is not subordinate if more than
4 one-third of the total usable volume of the building is devoted to
5 a use that is not a qualified purpose.

6 (iv) In the event an entire building does not qualify as a special
7 purpose building, a taxpayer may establish that a portion of a
8 building, and the foundation immediately underlying the portion,
9 qualifies for treatment as a special purpose building and
10 foundation if the portion satisfies all of the definitional
11 provisions in this subparagraph.

12 (v) To the extent that a building is not a special purpose
13 building as defined above, but a portion of the building qualifies
14 for treatment as a special purpose building, then all equipment
15 that exclusively supports the qualified purpose occurring within
16 that portion and that would qualify as Section 1245 of the
17 Internal Revenue Code property if it were not a fixture or affixed
18 to the building shall be treated as a cost of the portion of the
19 building that qualifies for treatment as a special purpose building.

20 (vi) Buildings and foundations that do not meet the definition
21 of a special purpose building and foundation set forth above
22 include, but are not limited to: buildings designed and
23 constructed or reconstructed principally to function as a general
24 purpose manufacturing, industrial, or commercial building;
25 research facilities that are used primarily prior to or after, or prior
26 to and after, the manufacturing process; or storage facilities that
27 are used primarily prior to or after, or prior to and after,
28 completion of the manufacturing process. A research facility is
29 not considered to be used primarily prior to or after, or prior to
30 and after, the manufacturing process if its purpose and use relate
31 exclusively to the development and regulatory approval of the
32 manufacturing process for specific biopharmaceutical products.
33 A research facility that is used primarily in connection with the
34 discovery of an organism from which a biopharmaceutical
35 product or process is developed does not meet the requirements
36 of the preceding sentence.

37 (5) Subject to the provisions in paragraph (2) of subdivision
38 (b), qualified property also includes computer software that is
39 primarily used for those purposes set forth in paragraph (1) or (2)
40 of this subdivision.

1 (6) For broadband services, qualified property means tangible
2 personal property capable of providing broadband services.

3 (7) Qualified property does not include any of the following:

4 (A) Furniture.

5 (B) Facilities used for warehousing purposes after completion
6 of the manufacturing process.

7 (C) Inventory.

8 (D) Equipment used in the extraction process.

9 (E) Equipment used to store finished products that have
10 completed the manufacturing process.

11 (F) Any tangible personal property that is used in
12 administration, general management, or marketing.

13 (e) For purposes of this section:

14 (1) “Biopharmaceutical activities” means those activities that
15 use organisms or materials derived from organisms, and their
16 cellular, subcellular, or molecular components, in order to
17 provide pharmaceutical products for human or animal
18 therapeutics and diagnostics. Biopharmaceutical activities make
19 use of living organisms to make commercial products, as
20 opposed to pharmaceutical activities that make use of chemical
21 compounds to produce commercial products.

22 (2) “Fabricating” means to make, build, create, produce, or
23 assemble components or property to work in a new or different
24 manner.

25 (3) “Manufacturing” means the activity of converting or
26 conditioning property by changing the form, composition,
27 quality, or character of the property for ultimate sale at retail or
28 use in the manufacturing of a product to be ultimately sold at
29 retail, and includes the generation of electricity. Manufacturing
30 includes any improvements to tangible personal property that
31 result in a greater service life or greater functionality than that of
32 the original property.

33 (4) “Other biotechnology activities” means activities
34 consisting of the application of recombinant DNA technology to
35 produce commercial products, as well as activities regarding
36 pharmaceutical delivery systems designed to provide a measure
37 of control over the rate, duration, and site of pharmaceutical
38 delivery.

1 (5) “Primarily” means tangible personal property used 50
2 percent or more of the time in an activity described in
3 subdivision (d).

4 (6) “Process” means the period beginning at the point at which
5 any raw materials are received by the qualified taxpayer and
6 introduced into the manufacturing, processing, refining,
7 fabricating, or recycling activity of the qualified taxpayer and
8 ending at the point at which the manufacturing, processing,
9 refining, fabricating, or recycling activity of the qualified
10 taxpayer has altered tangible personal property to its completed
11 form, including packaging, if required. Raw materials are
12 considered to have been introduced into the process when the
13 raw materials are stored on the same premises where the
14 qualified taxpayer’s manufacturing, processing, refining, or
15 recycling activity is conducted. Raw materials that are stored on
16 premises other than where the qualified taxpayer’s
17 manufacturing, processing, refining, fabricating, or recycling
18 activity is conducted, are not considered to have been introduced
19 into the manufacturing, processing, refining, fabricating, or
20 recycling process.

21 (7) “Processing” means the physical application of the
22 materials and labor necessary to modify or change the
23 characteristics of property.

24 (8) “Refining” means the process of converting a natural
25 resource to an intermediate or finished product.

26 (9) “Research and development” means those activities that
27 are described in Section 174 of the Internal Revenue Code or in
28 any regulations thereunder.

29 (10) “Small business” means a qualified taxpayer that meets
30 any of the following requirements during the taxable year for
31 which the credit is allowed:

32 (A) Has gross receipts of less than fifty million dollars
33 (\$50,000,000).

34 (B) Has net assets of less than fifty million dollars
35 (\$50,000,000).

36 (C) Has a total credit of less than one million dollars
37 (\$1,000,000).

38 (D) Is engaged in biopharmaceutical activities or other
39 biotechnology activities that are described in Codes 2833 to
40 2836, inclusive, of the Standard Industrial Classification (SIC)

1 Manual published by the United States Office of Management
2 and Budget, 1987 edition, and has not received regulatory
3 approval for any product from the United States Food and Drug
4 Administration.

5 (11) “Broadband services” means services that provide a
6 connection to the Internet at speeds greater than 128 kilobits per
7 second downstream.

8 (f) The credit allowed under subdivision (a) shall apply to
9 qualified property that is acquired by or subject to lease by a
10 qualified taxpayer, subject to the following special rules:

11 (1) A lessor of qualified property, irrespective of whether the
12 lessor is a qualified taxpayer, is not allowed the credit provided
13 under subdivision (a) with respect to any qualified property
14 leased to another qualified taxpayer.

15 (2) (A) For purposes of determining the qualified cost paid or
16 incurred by a lessee in any leasing transaction that is not treated
17 as a sale under Part 1 (commencing with Section 6001), the
18 following rules apply:

19 (i) Except as provided by subparagraph (C) of this paragraph,
20 paragraphs (1) and (3) of subdivision (b) do not apply.

21 (ii) Except as provided in subparagraph (B) and clause (iii),
22 the “qualified cost” upon which the lessee shall compute the
23 credit provided under this section shall be equal to the original
24 cost to the lessor (within the meaning of Section 18031) of the
25 qualified property that is the subject of the lease.

26 (iii) The requirement of paragraph (2) of subdivision (b) shall
27 be treated as satisfied only if the lessor has made a timely
28 election under either Section 6094.1 or subdivision (d) of Section
29 6244 and has paid sales tax reimbursement or use tax measured
30 by the purchase price of the qualified property (within the
31 meaning of paragraph (5) of subdivision (g) of Section 6006).
32 For purposes of this subdivision, the amount of original cost to
33 the lessor that may be taken into account under clause (ii) may
34 not exceed the purchase price upon which sales tax
35 reimbursement or use tax has been paid under the preceding
36 sentence.

37 (B) For purposes of applying subparagraph (A) only, the
38 following special rules shall apply:

39 (i) The original cost to the lessor of the qualified property shall
40 be reduced by the amount of any original cost of that property

1 that was taken into account by any predecessor lessee in
2 computing the credit allowable under this section.

3 (ii) Clause (i) does not apply in any case where the
4 predecessor lessee was required to recapture the credit provided
5 under this section pursuant to subdivision (g).

6 (iii) For purposes of this section only, in any case where a
7 successor lessor has acquired qualified property from a
8 predecessor lessor in a transaction not treated as a sale under Part
9 1 (commencing with Section 6001), the original cost to the
10 successor lessor of the qualified property shall be reduced by the
11 amount of the original cost of the qualified property that was
12 taken into account by any lessee of the predecessor lessor in
13 computing the credit allowable under this section.

14 (C) In determining the original cost of any qualified property
15 under this paragraph, only amounts paid or incurred by the lessor
16 on or after January 1, 2006, shall be taken into account.

17 (D) Notwithstanding subparagraph (A), in the case of any
18 leasing transaction for which the lessee is allowed the credit
19 under this section and thereafter the lessee (or any party related
20 to the lessee within the meaning of Section 267 or 318 of the
21 Internal Revenue Code) acquires the qualified property from the
22 lessor (or any successor lessor) within one year from the date the
23 qualified property is first used by the lessee under the terms of
24 the lease, the lessee's (or related party's) acquisition of the
25 qualified property from the lessor (or successor lessor) shall be
26 treated as a disposition by the lessee of the qualified property that
27 was subject to the lease under subdivision (g).

28 (3) For purposes of determining the qualified cost paid or
29 incurred by a lessee in any leasing transaction that is treated as a
30 sale under Part 1 (commencing with Section 6001), the following
31 rules apply:

32 (A) Paragraph (1) of subdivision (b) is applied by substituting
33 the term "purchase" for the term "construction, reconstruction, or
34 acquisition."

35 (B) Paragraph (3) of subdivision (b) applies.

36 (C) The requirement of paragraph (2) of subdivision (b) are
37 treated as satisfied at the time that either the lessor or the
38 qualified taxpayer pays sales or use tax under Part 1
39 (commencing with Section 6001).

(4) (A) In the case of any leasing transaction described in paragraph (2), the lessor shall provide a statement to the lessee specifying the amount of the lessor's original cost of the qualified property and the amount of that cost upon which a sales or use tax was paid within 45 days after the close of the lessee's taxable year in which the credit is allowable to the lessee under this section.

(B) The statement required under subparagraph (A) shall be made available to the Franchise Tax Board upon request.

(g) No credit is allowed if the qualified property is removed from the state, is disposed of to an unrelated party, or is used for any purpose not qualifying for the credit provided in this section in the same taxable year in which the qualified property is first placed in service in this state. If any qualified property for which a credit is allowed pursuant to this section is thereafter removed from this state, disposed of to an unrelated party, or used for any purpose not qualifying for the credit provided in this section within one year from the date the qualified property is first placed in service in this state, the amount of the credit allowed by this section for that qualified property shall be recaptured by adding that credit amount to the net tax of the qualified taxpayer for the taxable year in which the qualified property is disposed of, removed, or put to an ineligible use.

(h) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and succeeding years as follows:

(1) Except as provided in paragraph (2), for the seven succeeding years if necessary, until the credit is exhausted.

(2) In the case of a small business, for the nine succeeding years, if necessary, until the credit is exhausted.

SEC. 4. Section 23649 is added to the Revenue and Taxation Code, to read:

23649. (a) For taxable years beginning on or after January 1, 2006, a qualified taxpayer is allowed a credit against the "tax," as defined in Section 23036, equal to 6 percent of the qualified cost of qualified property that is placed in service in this state.

(b) For purposes of this section, "qualified cost" means any cost that satisfies each of the following conditions:

(1) Is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 2006.

(2) Except as provided in paragraph (3) of subdivision (d) and subparagraph (B) of paragraph (4) of subdivision (d), is an amount upon which the qualified taxpayer has paid, directly or indirectly as a separately stated contract amount or as determined from the records of the qualified taxpayer, sales or use tax under Part 1 (commencing with Section 6001).

(3) Is an amount properly chargeable to the capital account of the qualified taxpayer.

(c) (1) For purposes of this section, “qualified taxpayer” means any of the following:

(A) A taxpayer engaged in those lines of business described in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373, inclusive, or Code 4911 of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(B) Any taxpayer that provides broadband services or leases equipment to a broadband services provider.

(C) A subsidiary, affiliate, partner, or coventurer of a taxpayer that provides broadband services or leases equipment to a broadband services provider.

(2) In the case of any passthrough entity, the determination of whether a taxpayer is a qualified taxpayer shall be made at the entity level and any credit under this section or Section 17053.49 shall be allowed to the passthrough entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph, the term “passthrough entity” means any partnership or “S” corporation.

(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.

(d) For purposes of this section, “qualified property” means property that is described as either of the following:

(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to 3999, inclusive, or Code 4911 of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, that is primarily used for any of the following:

(A) For the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(B) In research and development.

(C) To maintain, repair, measure, or test any property described in this paragraph.

(D) For pollution control that meets or exceeds standards established by the state or by any local or regional governmental agency within the state.

(E) For recycling.

(2) Computers and computer peripheral equipment, as defined in Section 168(i)(2)(B) of the Internal Revenue Code, that is tangible personal property as defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in SIC Codes 7371 to 7373, inclusive, of the SIC Manual, 1987 edition, that is primarily used to develop or manufacture prepackaged software or custom software prepared to the special order of the purchaser who uses the program to produce and sell or license copies of the program as prepackaged software.

(3) The value of any capitalized labor costs that are directly allocable to the construction or modification of property described in paragraph (1) or (2).

(4) In the case of any qualified taxpayer engaged in manufacturing activities described in SIC Code 357 or 367, those activities related to biotechnology described in SIC Code 8731, those activities related to biopharmaceutical establishments only that are described in SIC Codes 2833 to 2836, inclusive, those activities related to space vehicles and parts described in SIC

Codes 3761 to 3769, inclusive, those activities related to space satellites and communications satellites and equipment described in SIC Codes 3663 and 3812, or those activities related to semiconductor equipment manufacturing described in SIC Code 3559, or those activities related to electric power generation described in SIC Code 4911, “qualified property” also includes the following:

(A) Special purpose buildings and foundations that are constructed or modified for use by the qualified taxpayer primarily in a manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(B) The value of any capitalized labor costs that are directly allocable to the construction or modification of special purpose buildings and foundations that are used primarily in the manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(C) (i) For purposes of this paragraph, “special purpose building and foundation” means only a building and the foundation immediately underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subparagraph (A) (“qualified purpose”).

(ii) A building is specifically designed and constructed or modified for a qualified purpose if it is not economical to design and construct the building for the intended purpose and then use the structure for a different purpose.

(iii) For purposes of clause (i) and clause (vi), a building is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building for nonqualified purposes does not preclude the building from being a special purpose building. “Incidental use” means a use that is both related and subordinate to the qualified purpose. It will be

1 conclusively presumed that a use is not subordinate if more than
2 one-third of the total usable volume of the building is devoted to
3 a use that is not a qualified purpose.

4 (iv) In the event an entire building does not qualify as a special
5 purpose building, a taxpayer may establish that a portion of a
6 building, and the foundation immediately underlying the portion,
7 qualifies for treatment as a special purpose building and
8 foundation if the portion satisfies all of the definitional
9 provisions in this subparagraph.

10 (v) To the extent that a building is not a special purpose
11 building as defined above, but a portion of the building qualifies
12 for treatment as a special purpose building, then all equipment
13 that exclusively supports the qualified purpose occurring within
14 that portion and that would qualify as Section 1245 of the
15 Internal Revenue Code property if it were not a fixture or affixed
16 to the building shall be treated as a cost of the portion of the
17 building that qualifies for treatment as a special purpose building.

18 (vi) Buildings and foundations that do not meet the definition
19 of a special purpose building and foundation set forth above
20 include, but are not limited to: buildings designed and
21 constructed or reconstructed principally to function as a general
22 purpose manufacturing, industrial, or commercial building;
23 research facilities that are used primarily prior to or after, or prior
24 to and after, the manufacturing process; or storage facilities that
25 are used primarily prior to or after, or prior to and after,
26 completion of the manufacturing process. A research facility is
27 not considered to be used primarily prior to or after, or prior to
28 and after, the manufacturing process if its purpose and use relate
29 exclusively to the development and regulatory approval of the
30 manufacturing process for specific biopharmaceutical products.
31 A research facility that is used primarily in connection with the
32 discovery of an organism from which a biopharmaceutical
33 product or process is developed does not meet the requirements
34 of the preceding sentence.

35 (5) Subject to the provisions in paragraph (2) of subdivision
36 (b), qualified property also includes computer software that is
37 primarily used for those purposes set forth in paragraph (1) or (2)
38 of this subdivision.

39 (6) For broadband services, qualified property means tangible
40 personal property capable of providing broadband services.

(7) Qualified property does not include any of the following:

(A) Furniture.

(B) Facilities used for warehousing purposes after completion of the manufacturing process.

(C) Inventory.

(D) Equipment used in the extraction process.

(E) Equipment used to store finished products that have completed the manufacturing process.

(F) Any tangible personal property that is used in administration, general management, or marketing.

(e) For purposes of this section:

(1) “Biopharmaceutical activities” means those activities that use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities that make use of chemical compounds to produce commercial products.

(2) “Fabricating” means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(3) “Manufacturing” means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail, and includes the generation of electricity. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.

(4) “Other biotechnology activities” means activities consisting of the application of recombinant DNA technology to produce commercial products, as well as activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(5) “Primarily” means tangible personal property used 50 percent or more of the time in an activity described in subdivision (d).

(6) “Process” means the period beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, if required. Raw materials are considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified taxpayer’s manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified taxpayer’s manufacturing, processing, refining, fabricating, or recycling activity is conducted, are not considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(7) “Processing” means the physical application of the materials and labor necessary to modify or change the characteristics of property.

(8) “Refining” means the process of converting a natural resource to an intermediate or finished product.

(9) “Research and development” means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder.

(10) “Small business” means a qualified taxpayer that meets any of the following requirements during the taxable year for which the credit is allowed:

(A) Has gross receipts of less than fifty million dollars (\$50,000,000).

(B) Has net assets of less than fifty million dollars (\$50,000,000).

(C) Has a total credit of less than one million dollars (\$1,000,000).

(D) Is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, and has not received regulatory

1 approval for any product from the United States Food and Drug
2 Administration.

3 (11) “Broadband services” means services that provide a
4 connection to the Internet at speeds greater than 128 kilobits per
5 second downstream.

6 (f) The credit allowed under subdivision (a) shall apply to
7 qualified property that is acquired by or subject to lease by a
8 qualified taxpayer, subject to the following special rules:

9 (1) A lessor of qualified property, irrespective of whether the
10 lessor is a qualified taxpayer, is not allowed the credit provided
11 under subdivision (a) with respect to any qualified property
12 leased to another qualified taxpayer.

13 (2) (A) For purposes of determining the qualified cost paid or
14 incurred by a lessee in any leasing transaction that is not treated
15 as a sale under Part 1 (commencing with Section 6001), the
16 following rules apply:

17 (i) Except as provided by subparagraph (C) of this paragraph,
18 paragraphs (1) and (3) of subdivision (b) do not apply.

19 (ii) Except as provided in subparagraph (B) and clause (iii),
20 the “qualified cost” upon which the lessee shall compute the
21 credit provided under this section shall be equal to the original
22 cost to the lessor (within the meaning of Section 24912) of the
23 qualified property that is the subject of the lease.

24 (iii) The requirement of paragraph (2) of subdivision (b) shall
25 be treated as satisfied only if the lessor has made a timely
26 election under either Section 6094.1 or subdivision (d) of Section
27 6244 and has paid sales tax reimbursement or use tax measured
28 by the purchase price of the qualified property (within the
29 meaning of paragraph (5) of subdivision (g) of Section 6006).
30 For purposes of this subdivision, the amount of original cost to
31 the lessor that may be taken into account under clause (ii) may
32 not exceed the purchase price upon which sales tax
33 reimbursement or use tax has been paid under the preceding
34 sentence.

35 (B) For purposes of applying subparagraph (A) only, the
36 following special rules shall apply:

37 (i) The original cost to the lessor of the qualified property shall
38 be reduced by the amount of any original cost of that property
39 that was taken into account by any predecessor lessee in
40 computing the credit allowable under this section.

(ii) Clause (i) does not apply in any case where the predecessor lessee was required to recapture the credit provided under this section pursuant to subdivision (g).

(iii) For purposes of this section only, in any case where a successor lessor has acquired qualified property from a predecessor lessor in a transaction not treated as a sale under Part 1 (commencing with Section 6001), the original cost to the successor lessor of the qualified property shall be reduced by the amount of the original cost of the qualified property that was taken into account by any lessee of the predecessor lessor in computing the credit allowable under this section.

(C) In determining the original cost of any qualified property under this paragraph, only amounts paid or incurred by the lessor on or after January 1, 2005, shall be taken into account.

(D) Notwithstanding subparagraph (A), in the case of any leasing transaction for which the lessee is allowed the credit under this section and thereafter the lessee (or any party related to the lessee within the meaning of Section 267 or 318 of the Internal Revenue Code) acquires the qualified property from the lessor (or any successor lessor) within one year from the date the qualified property is first used by the lessee under the terms of the lease, the lessee's (or related party's) acquisition of the qualified property from the lessor (or successor lessor) shall be treated as a disposition by the lessee of the qualified property that was subject to the lease under subdivision (g).

(3) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is treated as a sale under Part 1 (commencing with Section 6001), the following rules apply:

(A) Paragraph (1) of subdivision (b) shall be applied by substituting the term "purchase" for the term "construction, reconstruction, or acquisition."

(B) Paragraph (3) of subdivision (b) shall apply.

(C) The requirement of paragraph (2) of subdivision (b) shall be treated as satisfied at the time that either the lessor or the qualified taxpayer pays sales or use tax under Part 1 (commencing with Section 6001).

(4) (A) In the case of any leasing transaction described in paragraph (2), the lessor shall provide a statement to the lessee specifying the amount of the lessor's original cost of the

1 qualified property and the amount of that cost upon which a sales
2 or use tax was paid within 45 days after the close of the lessee's
3 taxable year in which the credit is allowable to the lessee under
4 this section.

5 (B) The statement required under subparagraph (A) shall be
6 made available to the Franchise Tax Board upon request.

7 (g) No credit is allowed if the qualified property is removed
8 from the state, is disposed of to an unrelated party, or is used for
9 any purpose not qualifying for the credit provided in this section
10 in the same taxable year in which the qualified property is first
11 placed in service in this state. If any qualified property for which
12 a credit is allowed pursuant to this section is thereafter removed
13 from this state, disposed of to an unrelated party, or used for any
14 purpose not qualifying for the credit provided in this section
15 within one year from the date the qualified property is first
16 placed in service in this state, the amount of the credit allowed by
17 this section for that qualified property shall be recaptured by
18 adding that credit amount to the net tax of the qualified taxpayer
19 for the taxable year in which the qualified property is disposed
20 of, removed, or put to an ineligible use. The sale of stock for
21 which an election was made or deemed to have been made
22 pursuant to Section 338(g) or 338(h)(10) of the Internal Revenue
23 Code may not be treated as a disposition of qualified property to
24 an unrelated party for purposes of this subdivision.

25 (h) In the case where the credit allowed by this section
26 exceeds the "tax," the excess may be carried over to reduce the
27 "tax" in the following year, and succeeding years as follows:

28 (1) Except as provided in paragraph (2), for the seven
29 succeeding years if necessary, until the credit is exhausted.

30 (2) In the case of a small business, for the nine succeeding
31 years, if necessary, until the credit is exhausted.

32 SEC. 5. This act provides for a tax levy within the meaning of
33 Article IV of the Constitution and shall go into immediate effect.